

Message Text

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ACTION EB-04

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AMEMBASSY PARIS

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C O N F I D E N T I A L SECTION 1 OF 2 ROME 3652/1

LIMDIS

E.O. 11652: GDS

TAGS: EFIN, IT, IMF

SUBJ: PROGRESS OF IMF TALKS

PASS FRB

1. SUMMARY. ACCORDING TO ITALIAN SOURCES, IMF NEGOTIATIONS ARE PROGRESSING SATISFACTORILY BUT SLOWLY. STRONG PICK-UP OF ECONOMIC ACTIVITY IN LAST QUARTER 1976 AND DELAYED IMPACT OF FISCAL MEASURES IMPLY THAT GROWTH, ESPECIALLY IN THE FIRST HALF OF THIS YEAR, WILL BE STRONGER THAN PREVIOUSLY EXPECTED. CURRENT ACCOUNT IN BALANCE OF PAYMENTS WILL BE CORRESPONDINGLY WEAKER. IMF IS LOOKING IN PARTICULAR AT EXPENDITURE SIDE OF CASH BUDGET, WHILE INSISTING UPON RATIFICATION BY PARLIAMENT OF FISCALIZATION DECREE LAW. AMOUNT OF STANDBY WOULD APPARENTLY BE 450 MILLION SDR'S, WITH STANDBY PROGRAM EXTENDING INTO 1978. BANK OF ITALY DOES NOT SEEM TO ENVISAGE NEED FOR ANY SHORT-TERM FINANCIAL ASSISTANCE IN COMING WEEKS. FOLLOWING REPORT IS MAINLY CONFIDENTIAL

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BASED ON TREASATT DISCUSSIONS WITH ITALIAN IMF EXECUTIVE DIRECTOR DINI ON MARCH 4, BOI GOVERNOR BAFFI ON MARCH 5 AND TREASURY MINISTRY DIRECTOR GENERAL PALUMBO ON MARCH 6. END SUMMARY.

2. STATUS OF TALKS. DR. DINI SAID THAT HE WAS FAIRLY PLEASED WITH PROGRESS BEING MADE ON STANDBY TALKS. IMF MISSION, AND

PARTICULARLY ITS HEAD MR. WHITTOME, WAS CONDUCTING TALKS IN CALM AND PRAGMATIC WAY, RECOGNIZING POLITICAL LIMITATIONS ON ABILITY OF GOI TO ACT IN SOME ECONOMIC AREAS. NONETHELESS, STATISTICAL ESTIMATES WERE DIFFICULT AND ECONOMIC ANALYSIS WOULD TAKE TIME. FUND MISSION WOULD CERTAINLY STAY IN ROME THROUGH WEEK OF MARCH 7-11 AND MIGHT VERY WELL REMAIN INTO WEEK OF MARCH 14-18.

3. DINI SAID THAT HE HAD STRONGLY ARGUED WITH GOI THAT IT WAS DESIRABLE FOR IMF MISSION TO COME TO ROME IMMEDIATELY AND NOT AWAIT RATIFICATION OF FEBRUARY 4 "FISCALIZATION" MEASURE. HE HAD RECOGNIZED THAT THIS INVOLVED SOME RISK ON BOTH IMF AND ITALIAN SIDES IN EVENT THAT DIFFICULTIES WITH RATIFICATION SHOULD MAKE IT IMPOSSIBLE TO REACH AGREEMENT ON CRITICAL LABOR COST QUESTION. (IN CONTRAST, DURING COURTESY CALL BY FRB GOVERNOR COLDWELL ON BOI GOVERNOR BAFFI MARCH 5, BAFFI SAID THAT HE HAD STRONGLY ARGUED THAT IMF MISSION SHOULD HAVE WAITED UNTIL AT LEAST APRIL BEFORE RESUMING TALKS. HOWEVER, TREASURY MINISTRY EVIDENTLY SUPPORTED DINI VIEW.)

4. GROWTH AND BALANCE OF PAYMENTS. DINI SAID THAT ONE OF MAJOR QUESTIONS WHICH GOI AND IMF HAD BEEN EXPLORING DURING FIRST WEEK OF TALKS WAS IMPLICATION FOR 1977 GROWTH AND BALANCE OF PAYMENTS OF STRONGER THAN EXPECTED ECONOMIC RECOVERY IN 1976, PARTICULARLY IN FOURTH QUARTER. DINI SAID THAT GOI PRELIMINARY ESTIMATE OF REAL GROWTH FOR CY 1976 WAS 5.7 PERCENT. (IN ADDITION, BOI ARGUED THAT STABILIZATION MEASURES WILL NOT HAVE MAJOR IMPACT UNTIL SECOND QUARTER 1977 AT THE EARLIEST, AND THAT EARLIER FORECAST HAD ERRONEOUSLY IGNORED THIS TIME LAG.)
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GOI NOW BELIEVED THAT REAL GROWTH IN 1977 WOULD BE IN RANGE OF 2 TO 3 PERCENT. THIS ALSO IMPLIED WEAKER CURRENT ACCOUNT IN BALANCE OF PAYMENTS, WITH CURRENT ACCOUNT MOVING INTO FAIRLY MODEST DEFICIT OF PERHAPS \$500-1,000-MILLION.)

5. FISCAL POLICY. ON REVENUE SIDE, GOI CONTINUED TO BELIEVE THAT GROWTH OF TAX INCOME WOULD BE QUITE STRONG IN 1977. WHILE IMF MISSION APPARENTLY DID NOT QUESTION THIS PROSPECT, IT WAS NOT VERY INCLINDE TO ACCEPT UPWARD REVISION OF CASH REVENUES AS ADEQUATE OFFSET TO ANY POSSIBLE INCREASES IN EXPECTED CASH EXPENDITURES.

6. IMF MISSION WAS CLOSELY EXAMINING POSSIBLE CASH EXPENDITURES WHICH HAVE NOT BEEN INCLUDED IN CURRENT CASH BUDGET ESTIMATES (E.G., PAST AND CURRENT DEFICITS OF HOSPITALS, HEALTH INSURANCE FUNDS AND LOCAL GOVERNMENTS, COST OF NEW LABOR CONTRACT IN PUBLIC ADMINISTRATION AND OTHER ITEMS). BECAUSE OF INCREASING IMPORTANCE OF SOME OF THESE NON-BUDGET EXPENDITURES, FUND MISSION WAS CONCENTRATING MORE ON OVERALL EXPENDITURES OF

ENTIRE PUBLIC SECTOR, RATHER THAN JUST ON TREASURY BUDGET AND
NON-BUDGET CASH EXPENDITURES. POSSIBLY, DEFICIT CEILINGS WOULD
BE ESTABLISHED FOR ENTIRE PUBLIC SECTOR. DINI'S PERSONAL
OPINION WAS THAT THE TREASURY CASH DEFICIT MIGHT TURN OUT TO
BE MORE THAN CURRENT 9,800 BILLION LIRE TARGET, PERHAPS

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REACHING AS MUCH AS 12,000 BILLION LIRE. (ITALIAN PRESS HAS
REPORTED THAT 1977 DEFICIT OF ENTIRE PUBLIC SECTOR WOULD BE
IN RANGE 13-14,000 BILLION LIRE.)

7. LABOR COSTS. IMF WAS ALSO STRONGLY INTERESTED IN RATIFICA-
TION OF DECREE LAW ON PARTIAL FISCALIZATION OF SOCIAL INSURANCE
COSTS IN MANUFACTURING INDUSTRY. IN FACT, DINI SAID THAT IMF
WOULD NOT CONCLUDE STANDBY NEGOTIATIONS UNTIL RATIFICATION
WAS ASSURED. (HE DID NOT SUGGEST THAT FINAL VERSION OF MEASURE
NEEDED TO BE EXACTLY THE SAME AS THAT CONTAINED IN ORIGINAL
DECREE LAW.) DINI SAID THAT HE, PERSONALLY, WAS CONSIDERING
RECOMMENDING TO PRIME MINISTER ANDREOTTI AN INFORMAL MEETING
BETWEEN IMF MISSION AND ITALIAN LABOR CONFEDERATIONS. WHILE
MEETINGS WITH LABOR REPRESENTATIVES WERE NOT TRADITIONALLY PART
OF IMF STANDBY NEGOTIATIONS, THERE WAS NOW A PRECEDENT IN THE
RECENT-UK STANDBY TALKS. HE WAS NOT SURE THAT GOI WOULD AGREE
TO THIS IDEA, BUT THOUGHT THAT IT WOULD BE USEFUL FOR IMF
MISSION AND LABOR LEADERS TO HEAR EACH OTHER'S POINTS-OF VIEW

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AND IMF MIGHT EVEN SEEK INFORMAL ACQUIESCENCE OF LABOR UNIONS IN WHATEVER COMMITMENTS MIGHT BE MADE IN LABOR COST AREA.

8. GOI POSITION ON TALKS. DINI SAID THAT GOI WAS SEEKING TO CONVINCE IMF MISSION THAT ITS ACTIONS IN FISCAL AND LABOR COST AREAS WERE THE BEST THAT COULD BE EXPECTED AT PRESENT. GOI EXPECTED TO HOLD THE LINE ON BUDGET DEFICIT AND WOULD RE-EXAMINE STABILIZATION PROGRAM AT MID-YEAR. PARTICULARLY WITH REGARD TO LABOR COST QUESTION IN ORDER TO DETERMINE WHETHER FURTHER ACTION WAS REQUIRED.

9. SIZE AND TIME PERIOD OF STANDBY. DINI SAID THAT AMOUNT OF STANDBY WHICH WAS BEING DISCUSSED WAS 450 MILLION SDR'S. STANDBY PROGRAM WOULD EXTEND INTO 1978. (ITALIAN PRESS REPORTS THAT STANDBY WOULD BE FOR 18-MONTH PERIOD, PRESUMABLY CY 1977 PLUS FIRST HALF OF 1978.) GOI AND IMF WERE BEGINNING TO EXAMINE KINDS OF LOAN CONDITIONS THAT MIGHT REALISTICALLY BE ESTABLISHED FOR 1978, BUT HAD NOT GOTTEN VERY FAR AS YET.

10. SHORT-TERM ASSISTANCE. DURING MEETING BETWEEN GOVERNORS COLDWELL AND BAFFI ON MARCH 5, TREASATT INQUIRED WHETHER BOI WAS SATISFIED WITH DEVELOPMENTS IN FOREIGN EXCHANGE MARKET FOLLOWING RECENT ELIMINATION OF 7 PERCENT TAX AND REDUCTION IN PRIOR DEPOSIT FROM 25 PERCENT TO 10 PERCENT LEVEL. BOTH BAFFI AND BOI DIRECTOR GENERAL ERCOLANI SAID THAT THEY AHD BEEN QUITE PLEASED WITH PERFORMANCE OF LIRA. WHILE THERE HAD BEEN FAIRLY HEAVY INTERVENTION TO SUPPORT LIRA ON FEBRUARY 28 THROUGH MARCH 3, ON MARCH 4 INTERVENTION HAD BEEN ABOUT-ZERO. IT WAS TRUE THAT ITALY HAD RECEIVED RATHER LARGE INFLOWS OF SHORT-TERM SUPPLIER AND COMMERCIAL BANK CREDITS IN RECENT MONTHS, BUT BOI WAS REASONABLY CONFIDENT THAT CURRENT LEVEL OF ABOUT \$3 BILLION IN CONVERTIBLE CURRENCY RESERVES WOULD BE SUFFICIENT TO MEET MODERATE AMOUNTS OF SHORT-TERM CAPITAL OUTFLOW. (LATER, BOI BALANCE OF PAYMENTS EXPERTS MENTIONED THREEE FACTORS WHICH, COMBINED WITH CONTINUED TIGHT MONETARY POLICY AND AVAILABILITY OF RESERVES, WOULD SERVE LARGELY TO OFFSET EFFECT

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OF POSSIBLE SHORT-TERM CAPITAL OUTFLOWS: (A) RECENT RECEIPT FROM BUNDESBANK OF ABOUT \$100 MILLION DUE TO RISE IN PRICE OF GOLD HELD AS COLLATERAL UNDER GOLD LOAN, (B) ABOUT \$300-400 MILLION IN ADDITIONAL REPATRIATED CAPITAL UNDER AMNESTY PROVISION OF 1976 EXCHANGE CONTROL PENALTY LAW, AND (C) ABOUT \$500 MILLION IN RECEIPTS FROM LIBYAN INVESTMENT IN FIAT DUE IN MARCH.)

IN ANY CASE, BOI OFFICIALS DID NOT TAKE OPPORTUNITY AT MARCH
5 MEETING WITH GOVERNOR COLDWELL TO SUGGEST THAT SHORT-TERM
SWAPS OR SIMILAR FOREIGN FINANCIAL ASSISTANCE WOULD BE NEEDED
IN NEAR FUTURE. BEAUDRY

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